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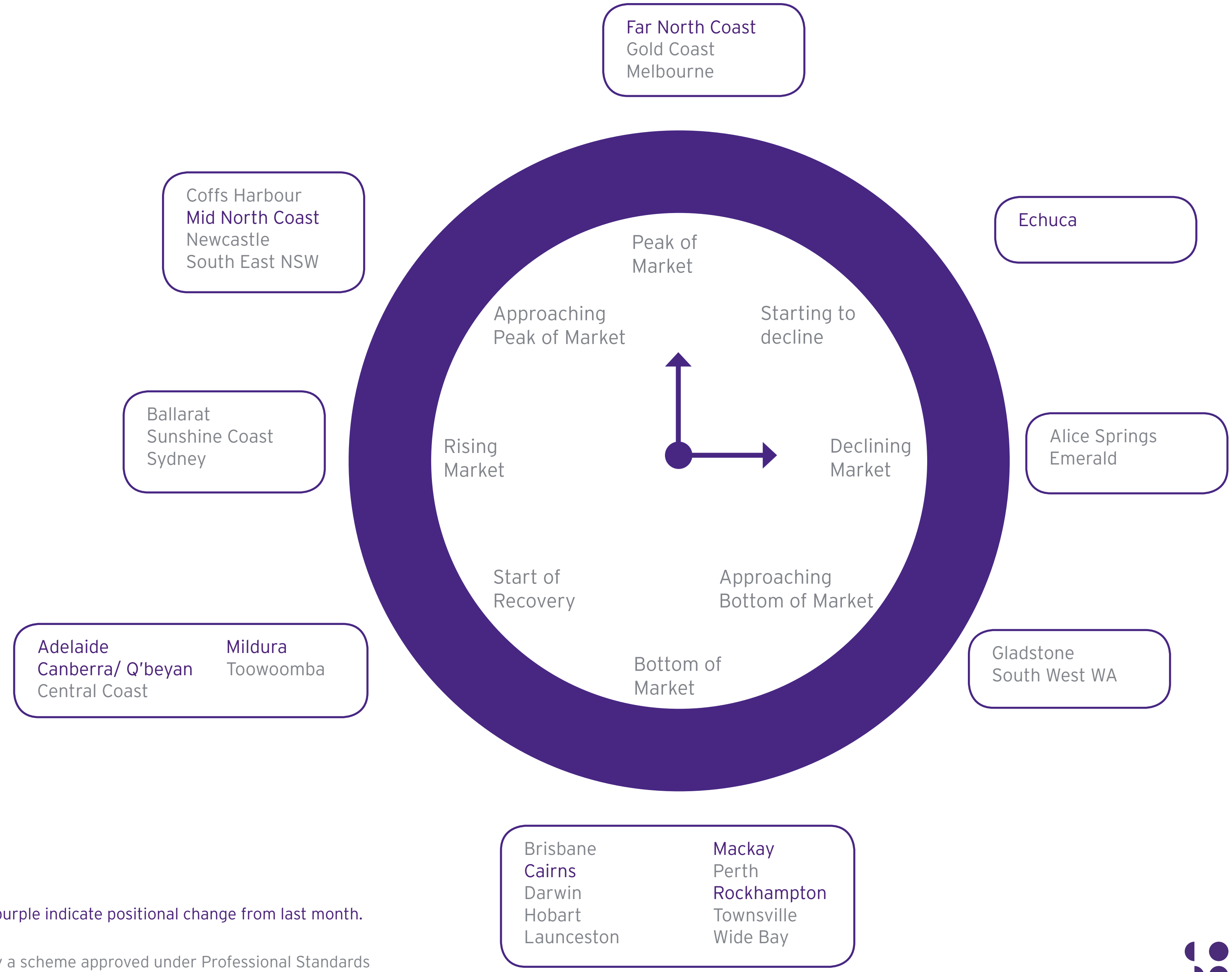
National Property Clock
August 2018
Office



Entries coloured purple indicate positional change from last month.

HERRON TODD WHITE COMMERCIAL

New South Wales

Overview

Talk to the layman about office property and their eyes might glaze over but that reaction fails to recognise the extraordinary advances in design and construction reflecting the evolution of this sector.

Office real estate and the way it's adapting to the demands of the modern workspace have a direct impact on owners, tenants and their workforce.

This month, we discuss how office property is changing across the nation and what you can look forward to in the future.

Sydney

The market demand for office space in Sydney, both within the CBD and in other commercial centres, has been very strong over the past 18 months. The CBD especially has seen a strong growth in demand from tenants, investors and owner-occupiers. Rental rates have reached in excess of $1,000 per square metre and sales have reached as high as $18,000 to $20,000 per square metre. Capitalisation rates are as low as 4%. According to the PCA, the vacancy rate was 4.7% in June and was the lowest in the country.

The higher price has forced many occupiers to look outside of the Sydney CBD but we are also seeing a trend towards decentralisation with more and more tenants seeking alternative locations. The biggest driver of this is access to public transport, improved facilities and flexible work spaces along with a drive towards locally positioned work spaces.

In the CBD, flexible floor plans that include common meeting spaces, the ability to hot desk and access to facilities and services remain common requirements for some larger organisations.

An example of suburban, non-traditional office locations with strong demand is Caringbah where a recently completed office development has seen a strong take up of space. The development offered small to medium sized strata lots. The new development includes an on site café, parking, shared meeting rooms, kitchens and breakout spaces. These office suites have been very popular with local owner-occupiers who require small to medium sized offices from which to operate their local businesses such as trades and professional services.

The growth and demand for creative office space has also continued. Areas that remain in demand and popular with owner-occupiers and tenants are the inner city and city fringe areas such as Surry Hills, Alexandria, Chippendale, Rosebery and Pyrmont. Creative office suites are prevalent within these areas and have been driven by the demand for smaller assets catering to start-up companies or established creative and professional businesses.

Developments that remain in demand in Surry Hills include several on Holt Street that offer creative style space with shared meeting and breakout rooms whilst being close to Central train station. These developments generally attract similar creative and local businesses. Another example is Rosebery, which has seen an increase in demand from local businesses. Several developments feature modern office space with well-designed shared meeting and breakout spaces which have proven popular with tenants.

New development is currently centred around Parramatta, Norwest and Macquarie Park with improvements in infrastructure and continued growth and demand driving the market. Norwest and Macquarie Park have seen a particularly strong increase in demand as buyers and tenants await the completion of the Sydney Metro train line. New developments have focused on modern, adaptable work spaces with a few now offering serviced office spaces.

We are seeing increased demand for serviced office space and the rise of co-working arrangements across several areas of Sydney, particularly the CBD and fringe areas including Pyrmont, Ultimo and Surry Hills. Tenant demand appears to emanate from creative and start up businesses looking for good quality, well located office space at an affordable rate with flexibility of terms.

For most tenants, end of trip facilities have become popular wish list items, especially in the CBD where many existing buildings have been upgraded to offer tenants more services. Examples of services now provided as part of a building's end of trip facilities include bike racks, dry cleaning services, fitness classes and showers. In some cases, these are now managed through an online portal.

The outlook for Sydney's office market looks positive for 2018 as demand continues to drive the market for both traditional type offices and more non-traditional options as more and more occupiers look for flexible working solutions.

Newcastle

The Newcastle office market has been changing rapidly over the past few years in the face of the changing nature of the office work environment as a whole. More office staff are working from home, hot desking or are being provided with more fluid work arrangements that allow a mix of work hours at home or in the office. Such arrangements are beneficial to employers as well as staff given the reduction in net lettable area costs in the city.

We've also seen a rise in smaller, single person operations offering professional services primarily from home but require a more professional space for meetings and presentations – hence the rise of professional services offices in and around the Newcastle CBD. Offices such as Newcleus at 2-6 Dick Street, Newcastle West offers "infrastructure and interaction to help people choose better in how they live and work" according to co-creator Tony Sambell. It has multi-use spaces including three meeting rooms, a large kitchen and a foyer, plus a café in the building. But it's the innovative and unexpected features that set it apart from other co-working ventures: a pair of sleep pods; a day bed; a walk-talk lane to encourage users to move while on the phone; plus a technology-free deactivation space where users can then tap back into their creativity by playing with board games and even juggling in the reactivation space.

For those who run a professional service that requires office staff and consultation, the Newcastle small office market has been dominated by the rise of the owner-occupier, generally purchasing the property via a self-managed superannuation fund and making the most of the tax benefits that come from a business paying rent to the fund under the terms of a commercial lease.

We've found that car parking is coming at more of a premium as kerbside and paid car parking facilities diminish in the face of new developments and infrastructure changes. Once completed, the light rail system will offer a quick way for pedestrians to get from Wickham to the east end of the city. What is required though is an affordable paid parking solution at the Wickham end of the line given the loss of car parking in the city, in Honeysuckle and at the now demolished ex-David Jones carpark on King Street. There was some hope that any development of The Store Site (adjacent to the Wickham Transport Exchange) may offer such a solution for the parking dilemma, however Canberra based property developer Doma will construct two residential towers, 13,000 square metre of office space and a bus interchange – the latter being a requirement of the Property NSW tender. Interestingly the Property NSW Tender also required 5,000 square metres of office and Doma has pledged well over this minimum office offering. This may indicate that more office space is required in the market at this stage in the property cycle than residential space which has been the star market performer in recent years.

Lismore

Office markets on the Far North Coast of NSW have not seen any significant changes. The biggest driver is government leasing and its influence has been as a result of volume and design requirements. Increasing requirements have included accessibility, standard and quality of AC, environmental ratings, quality of amenities, the need for open collaborative work spaces and open air space. Government tenants will pay a premium for suitable office space, giving landlords sufficient incentives to refurbish or redevelop high quality space. This ultimately increases the pool of available office space as they relocate.

Another significant proportion of new tenants includes non-profit organisations and employment companies, helping to balance the supply and demand and taking up spaces vacated by government tenants.

In Byron Bay we are seeing office tenants move out to the industrial space as it is more affordable and has superior parking and less disruption during high peak tourist seasons.

Office space in Ballina is concentrated along Tamar Street with a strong influence from government tenancies, traditionally in the higher quality spaces. This concentration attracts associated private companies and allied health services associated with the ageing population.

Lismore has a very broad range of space from high quality multi storey office buildings to converted dwellings and CBD shop top housing providing a modest standard of office space with a convenience factor. Recently we have seen an increase in shared office space with amenities, which includes sub-letting on a per room basis and provides an affordable option for small business owners and professionals with a superior return for the property owners. Local evidence indicates a premium of a 2.5 to 3.5 multiplier on achievable rent on a per room basis in comparison to an overall rate for a much larger space or entire office suite.

Rents:

- Lismore- $150 to $300 per square metre
- Ballina- $200 to $350 per square metre
- Byron Bay - $300 to $600 per square metre

Sales (smaller to medium sized buildings):

- Lismore - $800 to $1,500 per square metre and yields of 6% to 9%.
- Ballina - $3,000 to $5,500 per square metre and yields of 6% to 7.5%.
- Byron Bay- $11,000 to $15,000 per square metre and yields of 5% to 6.5%.

Our specialist commercial valuers at the Lismore office are experts on rental assessments for negotiations, determinations, commercial lease agreement renewals and the impact leases have on the value of your asset.

Coffs Harbour

There are two major office developments well advanced under construction. The developers have marketed these as open floor plan and adapted to the tenants' requirements. These developments feature large floor spaces.

There have been a number of developments placed on hold which plan to deliver small floor areas for single operators or small business. There has not been enough market interest or pre-leasing to meet funding development requirements.

Government departments have tended to centralise in recent years and there has been limited regional expansion. The National Disability Service has promoted some demand for predominantly smaller office accommodation. There remains a slight over supply of CBD located space. There has also been a trend towards the Isles Industrial Estate for quasi office accommodation at lower rental levels.

Wollongong

Small and medium sized companies dominate the local office market and as such floor plate requirements are small, generally ranging from 200 to 400 square metres requiring buildings to have flexibility in order to accommodate multiple-suite configuration. It is difficult to finance construction of new office development in the region given pre-leasing requirements, which are difficult to achieve due to the lack of large head office corporations seeking space in the local market. New construction is usually undertaken for government tenants such as the ATO anchored office building which was completed in 2013. New buildings for such tenants need to meet strict environmental performance standards from the outset and over the duration of the lease.

Construction will commence on Wollongong's first new office building since 2013. This is a large A-grade office building that will house IMB's head office, relocating from its dated Crown Street premises (acquired in 2015 by WIN Corporation as part of a significant overall land bank). Meanwhile demolition works have commenced on a new circa 5,300 square metre retail and office development on the corner of Keira and Victoria Streets. Details in respect to pre-committed tenants are not known and it is possible the building is being developed without a large portion of the building being pre-leased. Other large scale office projects are proposed in the Wollongong CBD, including Langs Corner and 25-27 Denison Street, although it is our understanding that approvals and leasing pre-commitments are still being sought for both proposals. If completed it is likely that the rents achieved will set a new benchmark in the local market.

The Illawarra commercial property market has shown clear signs of improvement over the past three years with an increase in sales volumes demonstrating improved confidence after a prolonged period of static conditions post the GFC. Investment transactions have increased as investors are enticed to the market by yield arbitrage not typically found in Sydney or other major capital cities. For investment grade assets at higher price points, yields tend to hover in the 8% to 8.5% range while sitting in the 6% to 8% range for lower valued assets that attract a broader pool of buyers.

Record prices were achieved in 2017 in the Wollongong CBD office market. In addition to local buyers, the region is attracting investors (private and second tier funds) from Sydney, interstate and overseas. Low interest rates and the increased buyer depth have resulted in strong yield compression despite rents largely remaining stagnant over this period. Low interest rates are a significant driver of the property market. There have been no sales of note over the past six to twelve months as no properties have been brought to the market.

Commercial leasing conditions in the Illawarra region have improved with local agents reporting increased enquiry levels and reduced vacancy periods for well-placed tenancies in good quality buildings and with good off street parking availability. However, incentives remain common with discounts between 10% and 20% of gross annual rent typically required to attract a new tenant. This incentive is usually in the form of a rent free period. While we expect rents for B-grade and C-grade space to remain flat, upward pressure is expected on rents for A-grade space due to the low vacancy rate and an increase in appetite from certain businesses to pay the required premium for A-grade.

Victoria

Melbourne

According to the Property Council of Australia's Office Market Report, Melbourne CBD's office overall vacancy rate overall reduced to 4.6% over the six months to January 2018. Melbourne CBD is now very close to the Sydney CBD vacancy rate.

The reduction in the vacancy is mainly due to the high net absorption rate of prime Melbourne CBD office stock. Leasing demand is currently very strong for good quality office stock within the CBD and city fringe suburbs, particularly in Cremorne and Richmond which have transformed into thriving technology precincts in recent years. Leasing agents are reporting a shortage of space and strong growth in face rents with reducing incentives. Net rents are in excess of $500 per square metre for new boutique office space in Cremorne and Richmond with minimal incentives offered.

The WELL Building Standard introduced by the International WELL Building Institute (IWBI) is underpinning change in commercial office building design. WELL v1 is a flexible building standard representing the future of modern design. The standard covers seven core concepts of health: air, water, nourishment, light, fitness, comfort and mind. The research of Wellness Team Australia indicates that employee engagement and performance as well as retention rates improve when organisations invest and focus on employee wellness. Tenants are seeking office buildings which provide good end of trip facilities and landlords now have an emphasis on flexible space and shared facilities in order to attract and retain tenants. For example, 101 Collins Street recently unveiled its luxury end of trip facilities with comparable six-star hotel amenities. A whole level of car parking within the building has been converted to create end-of-trip facilities including 24/7 change rooms with individualised grooming stations, personal lockers, 482 secure bike racks and a bike repair station. These state-of-the-art facilities set the benchmark for premium office buildings. Other A-grade office buildings such as 367 Collins Street and 360 Collins Street have also completed major upgrades of their lobbies and end of trip facilities. Both buildings have also activated any internal space with street exposure to incorporate retail units.

Environmental sustainability is another important aspect in modern workplace design. Large commercial landlords generally have green strategies in place for their buildings to reduce carbon footprints. New office buildings are also required to achieve a minimum 4.5 star NABERS energy rating in order to house government tenants.

Co-working office space is one of the fastest-growing trends of the office work environment. Research reports show the number of co-working spaces in Australia grew by 297% between 2013 and 2017, occupying 193,190 square metres across six cities. Melbourne has the largest concentration of co-working space with 49% followed by Sydney with 38%. In the Melbourne CBD, global co-working operator, WeWork, opened 11 full floors of new co-working space within a historic building at 401 Collins Street. This is after the recent opening of its first Melbourne office over six floors at 152 Elizabeth Street, the historic London Stores building. WeWork has also pre-committed to occupy 5,000 square metres over three floors at Lendlease's 839 Collins Street in Docklands Victoria Harbour precinct. We expect the co-working trend will continue to boom and large landlords such as Charter Hall, Lendlease and Mirvac are partnering with co-working operators including The Hub, WeWork and York Butter Factory to operate co-working spaces within their buildings.

We expect that more and more start-ups and small to medium size businesses will consider co-working as part of their accommodation strategies as it provides a sense of community and flexibility in leasing arrangements. Landlords may need to factor in sizeable co-working components within their buildings to maintain their building's positioning in a highly competitive market or risk losing tenants to those that do.

South Australia

Adelaide

Twenty years ago the millennials were wearing nappies, and while some may suggest they still are, they are now affecting the way we design offices....

Whilst this sounds alarmist, the effect on office design has been gradual and obvious characteristics have been an expectation for better, natural or environmentally friendly materials, designs that allow better sunlight and airflow, and accenting industrial features with timber, stone and plants for improved mental health. It has even extended to a shift in interior paint tones with warmer colours being utilised. Who likes hospital white anyway?

But there have also been less obvious changes, such as integrating technology into workplace design. As desktop computers become obsolete and are replaced by slimmer tablets and laptops, there are products available now which include wireless charging stations and multi-media functions within office furniture.

Or the impacts of an evolving office might be more obvious, at least from a human perspective. The younger generations are less fond of physically coming into the office now and the use of flexible workspaces is increasing with staff creating their personalised home office as the use of Skype, Google documents and video calls become more widely used for business purposes. Workstations that are completely interchangeable between staff are common now and desk ownership is fast becoming a thing of the past.

A real example of the above trend is the inclusion of end of trip facilities. The end of trip facility used to be the local bar; now it is lockable bike storage with showers and lockers. It has become a major selling point for new buildings and major refurbishments. Adelaide has not been immune to this type of refurbishment with 1 King William Street now providing the ability to store over 200 bikes with lockers.

All in all the older generation can complain about the millennials but in terms of our day to day they are set to give us more than just smashed avo on our toast.

The Adelaide CBD office market is best characterised by low levels of demand and limited new supply, high incentives and recently stabilised vacancy rates.

The net absorption within South Australia over the six months to January 2018 was 9,696 square metres - substantially higher than the previous six month period of 4,624 square metres and well above the ten-year average of 4,963 square metres. This has been driven predominantly by the lower grades, with Prime and A-grades having a combined negative absorption and B- and C-grades making up the difference. This is due to previous new supply creating high vacancies in the mid grades, creating strong incentive for lower grade tenants to upgrade.

Supply over the six months to January 2018 was low at 984 square metres, which is down on the previous six months of 5,227 square metres and these figures are both well down on the ten-year six-month average of 18,105 square metres.

Supply is expected to remain subdued until the anticipated completion of the Charter Hall building in the GPO Exchange development in the second half of 2019. Located at 2-10 Franklin Street, the two towers project is to provide a combined 24,500 square metres of A-grade office, 3,000 square metres of retail and fully refurbish the 12,500 square metres of the heritage GPO building. Construction started on the 19 level building in September 2017 with nearly half the building pre-committed by the SA Attorney General's Department. In April 2018, BHP announced a commitment to lease 10,000 square metres of the building, leaving only 10% of the building unoccupied.

Another development is the $100 million 19-storey, mixed use development on Pitt Street. The U City development by Uniting Communities is to provide retirement living, disabled respite accommodation and 6,600 square metres of office space, over 65% of which is proposed to be owner-occupied.

Whilst these two developments are predominantly pre-committed, there will be pressure to backfill vacated space. Adding to this is the 5,671 square metres of refurbished space due to become available throughout 2018, which will continue the cycle already being seen.

The shuffling of space has seen a strong use of incentives throughout the office market of between 35% and 45% for vacant space.

In general terms and on a gross face basis we are seeing rents within the following ranges:

- Prime grade office space is generally between $475 and $525 per square metre;
- A-grade office space is generally between $425 and $475 per square metre;
- B-grade office space is generally between $350 and $425 per square metre;
- C-grade office space is generally between $300 and $350 per square metre.

Queensland

Brisbane

In July, the PCA reported that Brisbane recorded its highest ever level of office vacancy with a headline rate of 16.9%. This is primarily on the back of the completion of the two major new buildings at 180 Ann Street and 480 Queen Street. There are now only two buildings under construction in the Brisbane CBD, with the imminent completion of 1 William Street and the 48,000 square metre office component of 300 George Street to be completed in late 2018.

Notwithstanding the headline figures, the Brisbane CBD is showing signs of recovery, with the first significant net absorption for some four years, totalling 42,742 square metres. It is now apparent that there has been significant new tenant interest in CBD office buildings, brought about by record high incentive levels and the availability of accommodation which was previously out of reach for many tenants.

In the fringe markets, the picture remains more constrained with further negative net absorption totalling 1,996 square metres. This brings the total vacancy to 12.9%. Of the primary fringe areas, both Spring Hill and the Urban Renewal areas showed positive absorption, whilst South Brisbane, Milton and Toowong continued to show negative net absorption, resulting in an increase in overall vacancies.

We are now however coming to the end of an extended supply cycle both in the CBD and in the fringe and there is unlikely to be any new significant commercial office development until we see recovery in effective rents.

In suburban markets, the overall picture remains relatively stable with very limited new supply, a significant quantity of stock available and difficult leasing conditions in many areas.

In terms of recent sales transactions, there is still good demand for well leased properties but a very significant differential between primary and secondary properties. Within the Brisbane CBD, there has only been one significant sale in the past six months, being that of 300 Queen Street at $188 million, showing a rate of $9,700 per square metre and a passing yield of circa 7%.

In fringe areas, there has been activity with some five significant sales, primarily in the Urban Renewal area. These have generally been of good quality and well leased properties.

There is a strong owner-occupier focus in suburban markets with reasonable demand for well located, near city, strata units in the sub $1 million price bracket. Demand for poorly leased larger properties is poor unless well tenanted.

Some recent notable sales in Brisbane include:

Property	Sale Price (,000)	NLA	Yield	$/m2 of NLA
300 Queen St, Brisbane	$188,000	19,364	7%*	$9,708
26 Commercial Rd, Newstead	$13,250	2,195	7.54%	$5,308
7 Brandl St, Eight Mile Plains	$20,500	5,264	8.45%	$3,680

* Reported

7 Brandl Street, Eight Mile Plains *(Source: www.commercialrealestate.com.au)*

26 Commercial Road, Newstead *(Source: www.realcommercial.com.au)*

City Pods *(Source: www.realcommercial.com.au)*

300 Queen Street, Brisbane (Source: www.realcommercial.com.au)

There is no doubt that challenging office market conditions will remain for some time, but given a reasonable hiatus in the development cycle we anticipate that conditions are likely to start their slow climb back.

For investors, we foresee slim pickings in the market generally with only properties having reasonable lease covenants and strong locations likely to find buyers easily.

Gold Coast

The Gold Coast office sector does not have a defined CBD. It has traditionally evolved within the five main business and retail hubs of Southport, Surfers Paradise, Bundall, Broadbeach and Robina/Varsity Lakes. Southport and Bundall tend to have dedicated office precincts whereas in the other areas the office buildings are interspersed with retailing or are in mixed use developments. These five hubs are also monitored by the Property Council of Australia in its biannual Office Market Report. Nerang and Beenleigh have also been other long standing, more prominent office areas, particularly underpinned by the establishment of government department occupied buildings.

Office product ranges from strata office suites to smaller stand-alone buildings to medium or highrise office towers up to 30,000 square metres in size. With a small business-dominated economy, a high percentage of Gold Coast office floor space seeks to cater to smaller end users. Consequently, strata office suites are a dominant office type, although in more recent years, there has been a trend towards small stand-alone type buildings, including the derivation CityPods created by Robina Group encompassing a group title development of 16

8 New St, Nerang - example of the type of small new office being built

smaller standalone buildings of 150 to 350 square metres that achieve sale prices in the order of $3,850 per square metre including car parking. .

The Gold Coast has a relatively narrow catchment bounded by ocean to the east and mountain ranges to the west. Therefore it expands laterally north and south, although the New South Wales border tends to be another obstacle to southern expansion of the region. Over the past ten years, residential development has expanded north along the M1 Pacific Motorway and now north-west towards Jimboomba and Browns Plains. Nodes of commercial development have followed to service the needs of the residents, with demand for office space satisfied in mixed use premises or smaller office buildings. A good example of this is Siganto Drive at Helensvale. Further, influence of increasing traffic and longer commuting times has exacerbated this trend towards more mixed use premises or smaller office buildings in the beachside business areas such as Miami, Burleigh Heads, Palm Beach and Coolangatta, the more affluent residential areas such as Hope Island and Paradise Point, on main arterial roadways such as the Smith Street Motorway and Ashmore Road and in close proximity to main shopping centres such as New Street at Nerang .

This changing trend of smaller standalone office buildings and provision of office floor space within mixed use premises is likely to continue, particularly

56 Nerang St, Southport - sold April 2018, $6.973M, AY 6.71%, Rate $3,467/m² NLA *(Source: www.commercialrealestate.com.au)*

as outer lying areas of the Gold Coast experience more and more residential expansion.

Hot desking, breakout areas, collaborative work spaces, expanded amenities...all of these emerging tenant requirement changes are influencing the Gold Coast office sector although possibly not to the same extent as in the capital city markets. Businesses appear to be looking forward to the ability of a tenancy to be down sized or more efficiently utilised from a business cost perspective. A regular shape, open plan and good natural light are important elements from a leasing up perspective. Reliable, high speed internet connectivity is vital nowadays, particularly with increasing numbers of staff seeking to work from home. Car parking and public transport for business owners and staff is also important.

Establishment of the Gold Coast light rail, which now runs from Helensvale through Southport and Surfers Paradise to Broadbeach has been a catalyst to attracting tenants back to the traditional office sectors, with this trend likely to continue. Conversely, congestion and a lack of car parking or readily available public transport is now diminishing the attractiveness of Robina and Varsity Lakes.

To close out this month's office sector review, the Gold Coast office market continues to reflect reasonably buoyant conditions. There continues to be a good number of office premises transactions, including several at the over $7.5 million mark. Yields have continued to firm, with recent transactions reflecting levels down to 6.25%, although the more dominant range would be 6.75% to 7.25% after allowance for permanent vacancies. Rental levels are reflecting growth, albeit moderate, and incentives are still in the range of 8% to 10% of first term rental. The Commonwealth Games in April 2018 has certainly assisted in keeping the Gold Coast in the spotlight. Provided interest rates remain at their current low levels, market conditions are unlikely to vary.

Cairns

The Cairns office market is relatively shallow and experiences limited sales activity and has had limited new development. The last large office building constructed in Cairns was the State Government office tower completed in 2010. There are no known new developments in the pipeline.

Commercial property sales in Cairns, inclusive of retail and commercial office premises, remain well below the peak levels achieved in the 2005 to 2007 period. Prices paid for secondary strata titled premises have been relatively stable since 2010 at around $2,500 to $3,000 per square metre of floor area.

Most new office space leasing demand is for smaller areas and for modern, good quality green star rated premises, however there is only a handful of such buildings in Cairns. These buildings achieve high levels of occupancy and are experiencing stable rent levels typically of $350 to $400 per square metre per annum. Demand for lesser quality space remains limited and there is a large oversupply of good quality non-inner CBD and well exposed secondary space in the $200 to $275 per square metre per annum rental range. These conditions have placed downward pressure on secondary rents and seen the emergence of incentives.

Overall the Cairns office market has experienced little change thus far during 2018 and is expected to see little change for the remainder of the year.

Townsville

The changing office culture over the last decade has seen a transition in how the current modern day office looks. Townsville is a relatively unsophisticated office market compared to the metro centres, however we too are seeing a trend change in office environments.

Gone are the days of workplaces being nose to the grindstone places, with office layouts becoming more functional, cost effective and flexible working environments. Centralisation has played a key role in the down sizing of areas and making better use of space through hot desking and open plan functional layouts. It is becoming more common to see breakout areas and soft furnishings providing a more relaxed environment with the mental wellbeing of staff being of high importance. On site shower facilities and bike storage areas are becoming important to enable staff to cycle to work or exercise during lunch breaks with an emerging desire for good natural lighting, high quality data speed and close proximity to cafes, parking and other social facilities.

The few major office buildings constructed in Townsville over the past ten years have been mostly for major corporate or government tenancies. It was recently announced that the ATO would relocate to a new building to be constructed in the fringe City Centre. It is reportedly a $25 million, four level lifted office with the ATO to occupy about 4,000 square metres. The current ATO lease is due to expire in 2020, which would see a vacancy in its current office at Stanley Place, resulting in a large amount of quality office space hitting the leasing market. The current depth of the local private sector will unlikely absorb this space given the already oversupplied state of the market.

Sunshine Coast

The office market on the Sunshine Coast had significant supply added during 2017, with a current vacancy rate as reported in the latest PCA report of 15% with a total of 25,686 square metres of vacant space. During 2017 there was 22,776 square metres of space added to the market, which accounted for the majority of the new space. Overall absorption was 7,139 square metres, which is circa twice the rate noted for the prior three year period.

The overall market outlook is therefore very cautious with significant white collar workforce growth required to take up the vacant space throughout the region.

There is significant incentive in the office market currently with typically circa 10% to 25% of the overall face rental. This is often given in terms of rent free periods of three to nine months depending on the length of the lease, which is generally from three to six years. Further fit out incentives are also common, particularly for new space.

There has been a significant change across the office market on the Sunshine Coast over the past three years. This has been in the opening and overall usage of office sharing and co working spaces. A number of operators have commenced these throughout the market and landlords with large office holdings are beginning to use these operators as a way to cultivate businesses and tenants within their office stock.

This co-working concept has been actively embraced by the market with tenants seeing the limited bond (typically no cost, with rent just paid monthly in advance) and limited other office fit out and start up costs as a real benefit. This enables tenants to reinvest and grow their businesses in the start up phase. If successful, they often are promoted by the co working provider to the landlord and placed within the office stock of the landlord.

In the current market, commencing businesses are utilising a number of the co working and serviced office spaces as it offers a low cost base in an overall sense with the flexibility of not having to sign long term leases with rental guarantees etc. This allows higher levels of capital to be invested back into the business.

Established businesses are typically more drawn to the traditional office market which offers longer term security of tenure. It also presents a more significant presence to the market in terms of the longevity of the business.

In heavily supplied markets, tenants generally look at a number of factors that influence their decision to take office space, including:

- Location and access - office users tend to judge location based on surrounding amenity and ease of access to main transport routes. What has also become more important over the past five years is access to digital services with internet speed crucial for many businesses.
- Quality of accommodation - this includes the quality of the building, lift access to upper levels, views, breakout areas and level of car parking, which is generally in the range of one space per 40 square metres of office space for larger tenancy areas.
- Investment decision of leasing versus purchasing - the overall interest rate environment, which will influence the decision whether to buy or lease. In the current market, there is a range of strata titled offices available across the region and we have seen an increase in overall sale levels in this market, which has improved value levels slightly. The continued low interest rate environment is influencing this market.

The office market is likely to continue to have a range of challenges in the short term to medium term, particularly with the introduction to the market of the Maroochydore Town Centre towards the end of 2018.

Central Queensland

One of the greatest changes in office tenancies in central Queensland towns over the past 20 years has been the reduction in space within the CBDs occupied by government and quasi government agencies. As service delivery has contracted to capital cities and to on line platforms, the demand for larger floor areas has declined. Over this time, many of the agencies still in regional areas have relocated out of the traditional main street precincts to secondary fringe locations, thereby fragmenting commercial development in some towns.

Typically office floor space requirements for all businesses are smaller as technology has improved efficiencies, increased the use of hot desks and reduced the amount of paper files and their associated storage space requirements. Smaller businesses have become even more adaptive with staff often working remotely. There has been a rise in shared office space on casual (short term) agreements.

Rockhampton

The office sector in Rockhampton has been relatively flat in recent years and without any significant demand for new office accommodation there has been very little development on this front. For modern office accommodation, rentals have stabilised and generally range from about $300 to $400 per square metre gross (including outgoings) for well located tenancies, with floor areas of up to about 300 square metres. For larger, modern tenancies, we have seen most leasing activity in the $250 to $275 per square metre gross range for better presented tenancies. There has been relatively weaker demand for these larger tenancies as few local businesses require large floor areas.

Mackay

The market remains oversupplied, but leasing activity is improving with the resurgence in coal mining improving business confidence and office demand. Small financial and insurance businesses have been the primary tenant group. Recent leasing activity has occurred around the city fringe for ground floor, tenancy areas of 150 to 250 square metres at consistent rates of about $250 per square metre per annum gross. The office rental market has experienced a downward correction. After a period of low activity at inconsistent rental levels, office rents now appear to have consolidated at a new lower level, approximately 20% below the 2012 peak.

Wide Bay

Recent demand for new office spaces throughout the Wide Bay has been limited and mainly centred on medical uses within the established medical precincts. Businesses have typically looked towards the established town centres such as the Bundaberg CBD and surrounds for office accommodation.

Rental levels for office accommodation have followed the trend of the commercial market in general, remaining stable with little movement in gross rental levels.

Good quality office tenancies that are well located can achieve rental levels in the order of $300 to $400 per square metre gross. The volume of new leases established in this segment is limited. Larger nationally recognised businesses are the most likely tenant, along with other medical businesses within an established medical precinct.

Lesser quality tenancies that are still well located can achieve rental levels in the order of $250 to $300 per square metre gross. Leases within this price segment of the market are more common than the range stated above, however, the total rental amount remains an issue for most businesses.

Lesser quality tenancies considered to be situated within secondary office locations generally achieve rental levels in the order of $150 to $200 per square metre gross. Typically these tenancies will attract smaller businesses or newer businesses that are still establishing themselves.

Northern Territory

Darwin

The Darwin commercial office remains in a moribund condition with limited demand which is commensurate with general economic conditions in Darwin at present.

Demolition of Cavenagh House at the corner of Cavenagh and Knuckey Streets has commenced. This multi-level office block is to be demolished and replaced with a new office building which will accommodate the NT Government's Health Department. The relocation of the Health Department to this building will displace older accommodation which is currently occupied in the CBD and service centres such as Casuarina. It is therefore not expected to have any positive effect on the net absorption rate for Darwin office space generally.

The Property Council of Australia reports that the vacancy rate is now in excess of 22% however it should be noted that the vast majority of these vacancies are in buildings of a lower B-, C- and D-grade standard. There is actually limited choice for A-grade accommodation around the CBD, however with the NT Government's accommodation requirements being satisfied there is also very limited demand for any type of office accommodation.

There is not as much of a differential in values between office space in the CBD and office space in suburban areas of Darwin, compared to the differential seen in other capitals. This is partly attributed to the shorter commuting times in Darwin. It can also be attributable to the various policy settings of the dominant tenant being the NT Government, which at various times has favoured decentralisation of offices to service centres such as Palmerston, Casuarina and (increasingly) Berrimah. However the reality is that Darwin is too small to efficiently operate on such a decentralisation. If the Darwin CBD is to function as the key central business district of the Northern Territory, then it is essential that most administrative operations be based there so that the CBD can enjoy the attendant benefits of a higher daytime population.

Western Australia

Perth

The most recent Property Council of Australia figures for the Perth CBD office market indicate the total vacancy rate decreased from 21.1% to 19.8% in the six months to January 2018. The total vacancy rate in West Perth however rose 1.7% to 16.7% for the same period.

Whilst there is some positive news with vacancy rates reducing overall, Perth's CBD still has the second highest vacancy rate of all capital cities in Australia.

The reduction in the overall vacancy rate can be attributed to a flight to quality phenomenon with the level of vacancy in the Premium and A-grade buildings being significantly less compared to B-, C- and D-grade spaces.

With a glut in the office leasing market and a flight to quality occurring, owners of B- and C-grade buildings are looking for conversion opportunities to residential, educational and even hospitality uses.

The significant deterioration in the Perth CBD and West Perth office leasing markets during 2016 (mainly as a result of reduced demand from resource sector tenants) coupled with historically low occupancy costs for office space in these traditional office districts has caused a rise in tenant migration from peripheral office precincts but also in tenants up-scaling to better quality accommodation.

Property owners have had to become proactive in trying to entice existing tenants to recommit and also in order to attract new tenants. This has resulted in substantial incentives being offered.

Furthermore, landlords are providing their existing and prospective tenants with bespoke floor plates, flexible work spaces, meeting hubs, refurbished foyers, some featuring concierge services, gymnasiums or wellness centres with some more innovative landlords looking at child care or child minding facilities within their buildings, in addition to the obligatory end of trip facilities of bike storage rooms and in some cases, bike repair shops.

Despite the findings of the PCA Office Market Report, discussions with real estate agents active in this sector confirm a generally soft office leasing market with downward pressure still being exerted on asking rental rates and a large volume of space available, coinciding with a lack of demand, particularly for secondary premises. In many cases tenancies are being listed for extended periods and with multiple agents.

In terms of capital transactions, demand for office property in the Perth CBD has been predominantly from institutions and foreign (south-east Asian) buyers seeking counter-cyclical acquisitions of secondary assets with good prospects for re-positioning.

Six major CBD and fringe office buildings transacted during the past six months. One of the more notable was Workzone West, 202 Pier Street, Perth which was purchased by Charter Hall for just over $125 million in June 2018.

Sales activity has however almost ceased within West Perth over the past 12 months. The lack of quality office stock with medium to long term WALEs combined with subdued economic conditions has affected transaction activity.

The outlook for the Perth office leasing market is to see a stabilisation in rental incentives and rents over the short term and no significant new building activity until at least 2020. Some uncertainty still exists as to the effect on the office leasing market of Woodside vacating 240 St Georges Terrace at the end of 2018, however it is understood that some of the impending vacant space is already pre-committed.

Overall, we anticipate that vacancies in the Perth CBD will stabilise and that vacancies in West Perth will increase further as tenants look to relocate back to the Perth CBD.

As tenants make the flight to quality, a two-tier market may eventuate with less attractive, lower grade buildings increasing in vacancy and more attractive Premium and A-grade assets in good central locations showing a decrease in vacancy.